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2020 Private Equity embraces the Special Purpose Acquisition Company during a record year

Insights - 08/10/2020

SPACs in 2020 –the new model for Private Equity?

"Unprecedented" has become the word of 2020; used to describe many of the challenges now facing the world it is a common feature of the year's news reports, but it is also a word though that aptly describes the present state of the Special Purpose Acquisition Company (**SPAC**) market – albeit in a much more positive sense. 2020 is already a record year for SPACs in the United States (**US**). According to one of the industry's leading data sources, SPAC Insider, nearly $40 billion in gross proceeds have been raised so far this year from 99 SPAC IPOS. That compares with a mere $13.6 Billion in gross proceeds from 59 SPAC IPOs in 2019 and $10.8 Billion raised in 2018 from 46 IPOs. That 2018 and 2019 were both seen as bumper years in themselves, setting their own, shows just how "unprecedented" the state of today's market for SPACs is.

As SPACs enjoy their record year, a number of Venture Capital (**VC**) and Private Equity (**PE**) firms have shown increasing interest in incorporating SPACs into their investment and structuring toolkits. In many respects, the aims of SPACs and customary VC/PE strategies are very similar and firms are now seeing that SPACs themselves might offer multiple advantages over the traditional acquisition and investment holding structures utilised by PE. The summer of 2020 has seen a number of PE backed SPAC launches, as well as announcements of proposed PE SPACs, which in total could amount to several billion dollars in IPO proceeds. If these SPACs prove successful, then the SPAC could become a major part of how PE does business over the next decade.

What is a SPAC?

A SPAC is a derived form of what is known in the US as a "blank-check company" – a company formed with no business purpose or undertaking other than to raise funds for some future undefined object. A SPAC is formed by its initial sponsors for the purpose of raising funds through an IPO, which will then be used to buy an existing business. The money raised in the SPAC's IPO must be held in an interest bearing trust account until a suitable target business is identified and then that money can only be used to fund the target's acquisition. The SPAC itself has a limited time in which to identify a target and complete its acquisition, usually between 18 and 24 months post IPO. If the SPAC fails to complete an acquisition by the applicable deadline, the funds raised in the IPO are returned to investors with interest. Investors also have the right to redeem their shares and receive back their original investment immediately before an acquisition takes place if they do not want to participate.

SPAC IPOs are structured as sales of "units" comprising both shares and derivative securities (usually warrants exercisable following an acquisition and/or "rights" that automatically convert into bonus shares following an acquisition). The units initially trade as a single security, but later, usually 52 days after the IPO, their component securities are allowed to trade separately.

The majority of SPAC listings have occurred in the US, predominantly NASDAQ, but SPAC activity is not confined to the US and SPACs have also listed on other world exchanges – including in Canada and the United Kingdom (**UK**).

Unique Opportunities

SPACS offer unique opportunities all round. For Investors (particular those seeking hedging options), the redemption return on pre-acquisition SPAC shares offers a relatively attractive yield with minimal risk (given the security of the trust account and redemption rights). As pre-acquisition SPAC shares typically trade at a discount and carry the right to the accrued interest in the trust account, their pre-acquisition redemption yield is comparable to US Treasuries. SPAC units though also carry features that give them clear advantages over Treasuries and similar hedges. As SPAC units will eventually separate into their component securities, this means that an investor may redeem his shares to receive back his investment prior to an acquisition, but still keep his warrants or rights alive – this means, in effect, that units grant a free option to participate in the post-acquisition business, allowing investors both safety and a chance at the upside of any deal.

What has made SPACs particularly popular in 2020 however is the opportunity they offer for those on the other side of the SPAC equation – potential targets. While the SPAC might be the purchasing entity, being acquired by a SPAC is actually a form of reverse takeover. Shareholders and management in the target will usually receive shares in the SPAC as part of the purchaser consideration (and in some cases become the majority shareholder group) and a number of members of the target's board will likely join the board of the listed entity. The target will therefore, in effect, reverse into the SPAC's listed status. Being acquired by a SPAC is therefore a real alternative to a traditional IPO for companies seeking to go public – and a number of those companies have actively courted SPACs as a potential conduit to market.

Traditional IPOs are still of course how many companies choose to go public, but that route is an increasingly expensive and time consuming process. Furthermore, in recent years, some of the pricing and valuation methods employed by bankers and underwriters in traditional IPOs have received adverse scrutiny. Taking a private company public via the SPAC route on the other hand can be managed on a faster timeline, for less cost and with more certainty around a company's valuation and equity capital raised.

The Perfect Storm

The record levels of SPAC activity already seen in 2020 is partly as a result of a "perfect storm" for SPACs in the US. Notwithstanding significant fluctuations during the first half of 2020, the US capital markets remain buoyant and many private business are still drawn to the opportunities a listing may bring. However, taking on the cost and time burdens of a traditional IPO and the inherent pricing/valuation risk noted above in the midst of a pandemic and an election year is less appealing. The alternative SPAC route to listing, by contrast, however now looks much more attractive.

The 2020 effect also comes after two strong years for SPACs in "ordinary times". These years also saw an increasing number of big name investors being associated with SPACs and a number of significant, high profile acquisitions by SPACs, including of Virgin Galactic, electric vehicle maker Nikola Corp and Luminar (acquired by a Gores Group SPAC at a value of around US$ 3 Billion). The increased level of interest in SPACs as an alternative IPO route has in turn increased overall interest in SPACs, helped cement their improved reputation, and has led to the current IPO boom we now see.

SPACs and Private Equity

While some believe that the current popularity of the SPAC is fleeting, and based chiefly on current uncertainties and a yet still buoyant exchange, its foundations seem more robust and go back, at least in the case of this present incarnation of the SPAC, to the beginning of the last decade.

SPACs first boomed in the 1980s but became mired in some of the financial scandals of the last years of the decade. A better regulated SPAC market grew and blossomed in the first decade of the 21st century (with SPACs accounting for almost 25% of all US IPOs in 2007) but this fell victim to the "Credit Crunch" and Great Recession of 2008. The current resurgence in SPAC activity started in 2012 and has seen steady year on year growth since then. That steady growth is based primarily on the real tangible advantages of SPACs over more traditional investment structures and methodologies.

SPACs can certainly provide general investors access to investments in acquisitions, buy-outs and other types of investment transaction which might otherwise be restricted to PE or VC funds. But those same funds themselves are now looking to use SPACs in their own strategies.

While the philosophy and goals behind a SPAC and typical PE or VC acquisition and management structure are not dissimilar, SPACs arguably have a number of key advantages over some of the traditional structures used by PE and VC firms for investment. For example SPACs offer:

1. Limited risk and certainty of return during their pre-acquisition phase - investors have the security and certainty of the return liquidation from the funds held in the trust account if the SPAC fails to complete an acquisition or the investor does not want to participate in one.
2. Greater liquidity: SPAC investors benefit from the liquidity of publicly-traded securities and the ability to control the timing of an exit.
3. High incentivisation: pending an acquisition there is typically no cash compensation paid to the SPAC's management team.
4. Additional leverage: including additional securities such as warrants in SPAC issued units gives investors the ability to leverage their initial investment by enabling them to invest more capital at pre-determined price (premium to the IPO price), even if the investor elects to receive back its capital in a pre-business combination redemption or tender offer.

These advantages have led to a number of PE firms now incorporating SPACs in their toolkits. In September 2020, for example, Apollo Global Management (a major PE player with over US$ 400 Billion assets under management) registered a new SPAC which plans to raise US$ 750 Million. Apollo's move follows a summer of SPAC related activity by established PE firms, including: RedBird Capital's launch of a SPAC in August that aims to acquire a professional sports team; Solamere Capital announcement that it plans to raise up to $300 million for a new SPAC; and reports in late August that TPG Capital is planning a pair of SPACs focusing on tech and social impact deals.

SPACs and Offshore

While most US listed SPACs are incorporated using Delaware corporations, for non-US sponsors (founders) seeking targets outside the US, a SPAC incorporated outside the US might be an appropriate alternative as it may offer a more efficient post acquisition structure and remove any additional US tax, legal or regulatory implications that may arise simply as a consequence of using a US vehicle. The SEC, NASDAQ and other relevant US exchanges allow for rules concessions for non-US issuers which qualify as "Foreign Private Issuers", and for foreign entities to follow more flexible "home country rules – thus allowing overseas concerns to access the US markets and be listed there, but without being subject to the full panoply of US legal and regulatory strictures.

NASDAQ and other leading US exchanges (and those in the UK too) allow listings by SPAC entities formed in most of the leading offshore jurisdictions, including the British Virgin Islands and Cayman Islands.

BVI and Cayman are favourite jurisdictions based on several factors, including: the particular suitability of their company law to SPACs; limited additional regulatory compliance requirements; tax neutrality; and the close similarity between aspects of BVI/Cayman and Delaware company law – which allows for an easy translation of existing standard legal forms and investor understandings from one jurisdiction to the other. Notable BVI and Cayman SPACs of 2020 include East Stone Acquisition Corp.'s US$ 138 Million IPO in February 2020, Yunhong International's US $69 Million IPO in March, ARYA Sciences Acquisition Corp II's US $149.5 Million IPO in July and Kismet Acquisition One Corp's US$ 250 Million IPO in August.

BVI SPACs, in particular, have pioneered novel SPAC features such as "rights", "fractional warrants" and the ability to extend SPAC life spans several years ago. The first India focused SPAC in recent years was a BVI company, as was the SPAC that resulted in the first ever NASDAQ listed Chinese finance business in 2016, and in 2018 a BVI SPAC, National Energy Services Reunited Corp, completed a unique simultaneous double business combination when it acquired two Middle Eastern oil businesses with a combined value over US$ 1.1 Billion.

At a Glance Guide to SPACs and alternative IPO techniques

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